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SUBJECT: ITALY: SCENESETTER FOR CODEL MCCONNELL

¶1. (U) Summary. Your visit to Rome comes at an important period in our relationship with Italy. As Italy's leadership undertakes engagement with the new Administration, Italians are eager to show that Italy remains committed to maintaining a strong relationship with the U.S. and is ready to contribute actively to efforts to address the issues that matter most to U.S. In fact, Italy has been a solid and active partner and has contributed to every U.S.- and NATO-led effort to address crises around the world, including Afghanistan/Pakistan, Iraq, the Balkans and the Middle East. You can reassure your counterparts that the U.S. continues to see Italy as an important ally and partner and thank them for their past support. In the near future, however, we will need robust efforts from Italy, coordinated with the U.S. and other allies, to make sustained progress in Afghanistan and to successfully resolve the Iranian nuclear issue. Both will require Italy to make tough economic choices that they might have been able to avoid previously. You may want to caution them privately, therefore, that despite the current economic crisis and its effect on Italy's budget, adequate funding of military, diplomatic and economic institutions is vital for Italy's continued influence in the world. From their side, your counterparts will be eager to hear your views about the U.S. Government's approach to the economic crisis and the development of this administration's political and economic priorities. End summary.

Domestic Politics

¶2. (U) This government enjoys a broad base of popular support and faces a weak and divided opposition. Silvio Berlusconi led a center-right coalition back into government in April 2008 after two years of a divided center-left government, assuming office as Prime Minister for the third time since 1994. Berlusconi has used the first year back in office to produce concrete deliverables on the law-and order agenda he promised during the electoral campaign and though many long-term solutions to most problems are still elusive, he has brought results in a number of areas. He addressed a long-standing garbage problem in Naples (though a permanent solution has not yet been devised), passed a sweeping new security law that has addressed some of the public's worries about street crime, and implemented a public finance law that has overhauled the annual budget process, which traditionally has eaten up months of Parliament's time. Many of these initiatives were adopted without the need to consult the opposition and Berlusconi is confident that he can continue to make progress on his agenda with little resistance from the divided center-left. Arresting Italy's long-term economic decline is Berlusconi's greatest challenge, however,

and the public will judge him accordingly.

Economic Outlook

13. (U) A conservative banking sector prevented Italy from suffering the kind of financial meltdown experienced elsewhere. Italian banks had little reason to engage in sub-prime lending, or buy significant assets derived from sub-prime loans overseas, given their dominance in their own high-margin, low-risk domestic market. Nevertheless, the worldwide economic downturn caught them at a time when earnings - as opposed to asset quality - were already coming under pressure due to Italy's anemic economic performance over the previous 3 years. Italy is now fully into a serious economic slowdown, with some economists predicting a GDP drop of almost 3 percent in 2009, the largest drop since 1975, when production shrunk by just over 2 percent. The Berlusconi government has managed the public aspects of the crisis well, focusing initially on maintaining the public's confidence in the banking system. The government implemented a modest economic stimulus package, which includes tax incentives for purchasers of some durable goods and autos.

14. (SBU) Italy's economic downturn, however, has produced budgetary pressure that has translated into cuts in the areas of greatest concern to the U.S.: military spending, economic assistance and expenditures in support of diplomatic efforts to address global crises. While budget pressures are real, Italy has focused its limited resources on producing short-term results that resonate with the public but provide little long-term effect. We have pressed Italy to prioritize

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its spending in areas that will preserve its influence and effectiveness, but a message from you would serve to reinforce that point.

G8: Italy Looking for an Opportunity to Shine

15. (U) Italy holds the presidency of the G-8 for 2009 and has embarked on an ambitious agenda. Its list of priorities for its G8 Presidency include global financial governance, energy and climate change, Afghanistan, peacekeeping and development, food security and non-proliferation. Italy is also seeking an expanded role for the G8's outreach session with the involvement of China, India, South Africa, Brazil, Mexico and Egypt. There are nine ministerials planned for this year with the Summit at La Maddalena, Sardinia in July. While Italy is looking at its G8 presidency as an opportunity to involve itself virtually in every global problem, we would prefer to see a more focused agenda with solid follow-up that would preserve the G8 as an influential forum that can effectively address a limited number of problems. Your visit presents an opportunity to press that point with your Italian counterparts.

Afghanistan/Pakistan: Italy's Engagement in the Greatest International Security Challenge

16. (U) With 8,800 troops deployed in overseas missions, Italy has been an indispensable ally in U.S.-led peacekeeping operations in the Balkans, Lebanon, and Iraq. As the world's attention shifts to Afghanistan/Pakistan, we are encouraging Italy to take its rightful place as one of NATO's strongest militaries with a significant contribution to the effort in Afghanistan. Italy is currently the sixth-largest force contributor to ISAF with 2,600 troops, a PRT in Herat and command of RC-West. But the Italian military's ability is limited by a lack of resources. Current Italian defense spending hovers at just below 1 percent of GDP, well below the 2 percent benchmark set for NATO countries. Your visit will be an excellent opportunity to thank Italy for the good work it does internationally, but also challenge Italy to join us in doing more and Afghanistan.

Iran: Real Action Needed

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¶17. (U) Italy is not a member of the P5 1 negotiating group on Iran but participates in policy discussions with us and other key European Allies through a multinational mechanism which also includes the UK, France and Germany, called the Quint. Italy believes that its large commercial relationship with Iran makes its participation in such discussions indispensable, but often laments that additional measures could produce economic pain for its public. Italy's trade with Iran is small in actual percentages (one to two percent of total exports/import), but is the second largest within the EU, behind Germany. You might take this opportunity to let your counterparts know that we view this problem with a sense of urgency and are looking to Italy and other key allies to fully and strongly support international efforts to bring Iran into compliance with its international obligations. Robust Italian participation in EU-wide and UN-mandated sanctions are an important element in the way forward.

Guantanamo Detainees

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¶18. (SBU) In our initial discussions with Italian officials, they have expressed their desire to work with us to resettle Guantanamo detainees so that we may arrive at an orderly closure of Guantanamo. EU and Italian constitutional limitations, however, could present some obstacles. You can express appreciation for Italian assistance to trouble-shoot these issues, and let your interlocutors know that we value their insights on how to navigate through the EU legal structure.

¶19. (U) Comment. Your interlocutors will welcome your first-hand assessment of the Middle East stops in your trip, especially given the U.S. Administration's developing views on the Peace Process, Iran and Syria. Your Italian hosts will also be eager to hear your insights about the development of the American plan to address the economic

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crisis. They are concerned that a wave of American protectionism could negatively impact their important export sector and will want to be reassured that the U.S. sees global economic recovery as important to U.S. recovery. They will also want to be reassured that the crisis will not affect the U.S. ability to continue to lead the world in addressing political and security crises. We look forward to your visit and hope to use it as an opportunity to build momentum as we continue to press our agenda with Italy.
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